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## Wage-Setting Institutions and Economic Growth

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## Wage-Setting Institutions and Economic Growth

### Abstract

Wage-setting institutions in several Asian and Latin American economies are compared and contrasted. The Asian economies have relied more on market wage determination, whereas the Latin American economies have encouraged institutions which push wages in key sectors up above market-clearing levels. Market wage determination, combined with export-led growth, has resulted in rapidly rising real wages in the context of full employment in the Asian economies. The Latin American economies have done less well.

### Keywords

wage determination, employment, Asia, Latin America

### Disciplines

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Wage-Setting Institutions and Economic Growth

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### Summary

Wage-setting institutions in several Asian and Latin American economies are compared and contrasted. The Asian economies have relied more on market wage determination, whereas the Latin American economies have encouraged institutions which push wages in key sectors up above market-clearing levels. Market wage determination, combined with export-led growth, has resulted in rapidly rising real wages in the context of full employment in the Asian economies. The Latin American economies have done less well.

## 1. Introduction

Most development analysts have paid little attention to the role of wage-setting institutions in determining the rate and character of economic growth. This omission is unfortunate for several reasons. First, a country's wage-setting institutions may play a pivotal role in facilitating or impeding economic growth; rapid growth has been made possible by market wage determination in the successful Newly Industrializing Countries (NICs) of East Asia. Second, some kinds of rapid economic growth have led to equally rapid improvements in wages and employment opportunities; this has occurred when economic growth has been of a labor-intensive, export-led character. Third, inherent in the very process of successful labor-intensive, export-led growth is a tendency for comparative advantage to shift; once full employment is attained, the competition among employers for scarce labor bids up wages and induces a shift away from unskilled- labor-intensive products.

Labor market institutions differ greatly among the various regions of the developing world. In this paper, we contrast wage-setting institutions in the East Asian NICs (Hong Kong, Korea,<sup>1</sup> Singapore, and Taiwan) with those of three countries in the Caribbean Basin (Costa Rica, Panama, and Jamaica). An overview of these differences appears in Section 2. Section 3 describes the key features of wage-setting institutions in the three Caribbean Basin economies, while Section 4 examines wage-setting institutions in the East Asian NICs. Section 5 explores the relationship between wages and economic growth. Section 6 concludes.

## 2. Contrasting Wage-Setting Institutions in Different Regions

Different wage policies are pursued in various regions of the developing world. The single most important issue is whether a country relies primarily on market wage determination or institutional wage determination.

In most of the countries of Latin America, the Caribbean, Africa, and South Asia, wages in key sectors are *not* determined by supply and demand, but rather by any or all of a number of nonmarket forces. These nonmarket forces often have potent influences in key sectors of those countries' labor markets. *Minimum wage laws* are common in many developing countries, at least in certain major sectors (e.g., large factories). When these laws are enforced, wages may be very much higher in the affected sectors than they might otherwise have been in the absence of minimum wage laws. *Labor unions* often are very strong, and are able to use their strength at the bargaining table to secure above-market wages for their members. *Pay policy with respect to public sector employees* frequently results in higher wages being paid to government workers than to comparable workers in the private sector. *Multinational corporations* sometimes are encouraged to pay high wages to local workers, lest those corporations be expelled from the country if they do not. Finally, *labor codes and protective labor legislation* may add substantially to the costs employers must pay when they hire workers. For these reasons, models with wage dualism, unemployment, and other such features are often used to describe these countries' labor markets (Harris and Todaro, 1970; Tidrick, 1975; Squire, 1981; Fields, forthcoming).

The newly industrializing countries of East Asia are different. Wages and other labor costs have *not* been inflated artificially there. Economic development in those economies has

depended on low labor costs. Policy makers in Hong Kong, Korea, Singapore, and Taiwan realized that if they were to gain and then maintain trade positions in world markets, the basis for doing so would be low price, which implied in turn the need for low wages. Their wage policies consequently prevented wages from exceeding market levels, as was true in other parts of the world. For the most part, wage levels in the East Asian NICs were left to be determined by supply and demand.

Market wage determination, prevalent in the economies of East Asia during most of their recent histories, has had several fundamentally important implications for the success of export-led growth in these economies. For one thing, market wage determination helped those countries avoid economic inefficiencies and misallocations of labor which might have arisen from distortions in wages. Market wage determination also naturally led employers to utilize the available labor force to the fullest extent possible, enabling those economies to pursue their inherent comparative advantages and produce goods intensive in labor. Another benefit of market wage determination is that it prevents substitution of capital in place of labor in the production process which, if it takes place, lessens employment. Yet another possible effect is that market wage determination diminishes the expected- income incentive in rural-urban migration; as shown in Fields (1984), the wage differential between manufacturing and agriculture is quite narrow in East Asia, much in contrast to most Latin American countries. Finally, market wage determination avoids unnecessarily high costs of production that might hamper a country's ability to sell its products profitably in world markets.

Besides the direct effects described above, market wage determination also has effects on other factors often emphasized in the development literature. For instance, price stability requires absence of wage push. Then too, attraction of foreign investment requires reasonable labor cost

and industrial peace. Wage institutions are one element among many determinants of development performance, but they merit more attention than is usually given them.

It is important to note that while the East Asian economies did not permit wages to be set well *above* market-clearing levels, it is also true that for the most part they did not hold wages artificially *below* market-clearing levels either. But in Singapore in the 1970s and apparently in Korea more recently, wage repression was practiced. This point is dealt with further below.

The balance of this paper compares wage-setting institutions in select countries.

### 3. Wage-Setting Institutions in Costa Rica, Panama, and Jamaica

Many countries in Latin America and the Caribbean have powerful wage-setting institutions. The general situation in Latin America and the Caribbean is that public policy encourages institutional forces which push the wages of certain groups of workers (but not others) above market levels.<sup>2</sup>

To illustrate in more detail, we present here the situation in three countries, each of which has an important wage institution which causes wages of certain workers to deviate from market levels.

#### (a) *Costa Rica*

In general, a great deal of competition prevails within the private sector labor market in Costa Rica. Wages are set largely in accordance with supply and demand. When economic conditions have been favorable, real wages have risen and job composition has improved; but



when Costa Rica suffered a severe economic crisis in the early 1980s, falling labor earnings led the decline (Fields, 1988).

Turning now to institutional forces, unions are present, but they cover only a small fraction of the private sector labor force. Even where unions exist, they do not raise wages much above the levels prevailing in the nonunionized sectors of their economies.<sup>3</sup> Costa Rica also has minimum wages. The authorities seek to keep the minimum wage growing in line with productivity but not faster (Gregory, 1981; Naranjo, 1985; Pollack, 1985). Starr (1981, p. 50) reports that minimum wages have less of an effect on actual wages paid in Costa Rica than in other Latin American countries. We may thus conclude that neither union wage-setting nor minimum wages has an important influence on market wage levels in Costa Rica.

The most important nonmarket force influencing wages in Costa Rica is public sector labor market policy.<sup>4</sup> Wages in the public sector are about twice as high as those in the private sector. These differentials remain even after standardizing for differences in the levels of education and experience of workers in the two sectors (Uthoff and Pollack, 1985; Gindling, 1986). Because of the higher pay in the public sector, private sector workers throughout Costa Rica aspire to public sector jobs. In response to the pressure for government jobs both from private sector workers and from the unemployed, the government has expanded public sector employment (MIDE- PLAN, 1984, p. 23). This has led to labor shortages in the private sector in certain occupations, especially those requiring the highest amounts of education. The growth of public sector employment at above-market wage rates has diverted funds from other uses and is not obviously the best use of those resources. Serious thought should be given to two aspects of policy concerning public sector labor markets in Costa Rica: whether to freeze the amount of total employment in that sector, as was agreed upon but apparently not effectuated; and whether

to gradually bring public sector wage levels more into line with those in the private sector. Given the need for austerity in Costa Rica, these possibilities may soon become realities.

Another policy issue is the financing of social security.<sup>5</sup> Costa Rica's social security system is among the most advanced in the developing world. It provides public assistance in the areas of health, food, and nutrition; housing; training; and income security for the young, the family, and the elderly. The National Planning Ministry estimates that the amount spent on social security is equivalent to 10% of the central government's budget (MIDEPLAN, 1984, p. 16). These large expenditures are financed by a payroll tax, which amounts to 9.25% of payroll for employers and 5.5% of payroll for employees; as a percentage of disposable income, the taxes constitute considerably larger percentages than these. Payroll taxes generate disincentives to employment of labor and encourage the substitution of labor-saving technology. The policy question here is whether the payroll tax should continue to be relied upon to finance social security in Costa Rica, or whether income taxes and other sources that do not militate against employment should be used instead.

#### (b) *Panama*

In Panama, the most important institutional influence on the labor market is that country's labor code. Comprehensive studies of Panama's labor code have been conducted by Butelman and Videla (1985) and Spinanger (1985), from which the following description is drawn.

The labor code is an ambitious undertaking, aimed at regulating wages and other labor market conditions throughout the Panamanian economy.

Among the areas covered are:

- (i) Policies directly influencing pay levels: legal minimum wages, contract minimum wages and collectively bargained wage increases.
- (ii) Measures directed toward job rights: employment security, antidiscrimination legislation.
- (iii) Actions aimed at job environment: work rules, job/occupational training.
- (iv) Social legislation: maternity leave, paid sick leave, unemployment compensation.
- (v) Policies affecting the economic environment: collective bargaining framework, bureaucratic and legal regulations.

Not only are these provisions on the books but they are enforced vigorously. Consequently, they have a very considerable bearing on the functioning of labor markets.

Panamanian employers report that the labor code provisions that have the greatest influence on them are:

(i) Hiring and firing aspects: Workers in Panama essentially have job security after two years. Employers are not free to dismiss workers after that time. Dismissal of a worker who has been in service a long time requires severance pay amounting to several years' wages. A dismissal determined to be unjust carries a 50% penalty beyond that. Employers therefore are understandably reluctant to dismiss workers for any reason, justified or otherwise.

(ii) Regulations regarding unions: The labor code specifies rules for collective bargaining and provides that no collective bargaining agreement can worsen conditions already existing. This limits the ability of wages to respond to adverse changes in product market conditions, whether in individual markets or for the economy generally if macroeconomic conditions cause the economy to turn downward. With devaluation not an option (the Panamanian Balboa is always worth one US dollar), much of the adjustment in this latter case would occur in the form

of unemployment, e.g., by firms not filling vacancies. Presumably wage rigidity in unionized sectors also spills over into some nonunionized sectors.

(iii) Wage costs: Labor costs are raised by the labor code's provisions regarding social security benefits including unemployment insurance, paid vacations and holidays, paid sick days, and a 13th month bonus. Butelman and Videla (1985) estimate that because of these provisions, a wedge of 45% is driven between the market wage and the perceived cost of employment.

Panama's labor code reduces the flexibility of the labor market and adds to labor costs.

Spinanger (1985, p. 49) estimates that labor costs are 90% higher under the labor code than they would be in its absence. He concludes "Panama is suffering, to a large extent, from classical unemployment. . . These policies have increasingly come into conflict with the need — or rather the necessity — for flexibility in the labor market. It would be quite correct to state that many of the unemployed were just priced out of the market."<sup>6</sup>

### (c) *Jamaica*

Wage differentials for comparable labor are a prominent feature of the Jamaican labor market. Trying to explain the conjunction of high unemployment and rising real wages in the mining and manufacturing sectors, Tidrick writes as follows:

None of these puzzling features of Jamaican wage and employment patterns can be fully understood without reference to the distorted wage structure, that is, a wage structure in which workers of the same skill level receive different wages in different industries. *The Jamaican wage structure is clearly distorted by this definition.* Disparities among major sectors are dramatic. Unskilled bauxite mining workers earn about *twice as much* per week as unskilled workers in transportation or construction, the two next most highly paid industries. (In fact, *unskilled* mining workers earn more than *skilled* construction workers.) Unskilled construction workers, in turn, earn almost *two and one-half times as much* as agricultural workers. [Emphasis added]<sup>7</sup>

These observations led him to construct a model of a “wage-gap economy,” similar in many respects to the labor market characterization of Harris and Todaro (1970).

The single most important factor responsible for the wage gap in Jamaica is trade unions. Jamaica has two major political parties, each of which maintains close links with a major trade union federation. In exchange for the unions’ political support, whichever political party is in power has endeavored to strengthen the unions’ hands. In consequence, unions receive government encouragement of collective bargaining and through legislative action. But of course, the Jamaican economy is not advanced enough to provide jobs at such high wages for all. Those who are not able to find such jobs either end up unemployed searching for high-wage jobs, or underemployed in lower-paying jobs in agriculture or elsewhere.

Another institutional factor responsible for pushing wages above market levels for certain groups of workers in Jamaica is the existence of enclave industries. In bauxite mining, for example, production is very capital-intensive and energy-intensive, but few workers are needed. Hence, labor cost is a very minor part of total cost. Because of this, the mining companies are able to pay relatively high wages to local workers with only a small addition to total costs.

These two institutional factors — strong unions and the enclave economy — are not independent. Speaking of the mining industry, Chernick writes:

... most of these firms are owned, controlled, and managed by foreigners. This places them in a relatively weak bargaining position in relation to the unions, which are often supported by governments with which these same employers must deal on many other issues which vitally affect their firms' profitability.<sup>8</sup>

From the point of view of the foreign firms facing very powerful unions supported by the government, it may be better to pay high wages. Which is worse: to accede to the demands of the mineworkers’ union or to endure a work stoppage, with consequent idleness of expensive capital

equipment? Which is worse: to pay high wages to a relative handful of workers, thereby achieving a reputation as a good corporate citizen, or not to pay such wages, thereby risking the wrath of a populist government which might nationalize the firms in the interests of “preventing exploitation”? In such circumstances, it may be in the companies’ profit-maximizing interests to agree to pay higher than market-clearing wages.

In political economy terms, it appears that very little is going to be done about institutional wage setting. In the words of Chernick:

Clearly, any serious attempt on the part of governments to reduce the wage gap by imposing upper limits on negotiated wage rates will collide with the self-interest of the trade unions. In most CARI- COM countries [Caribbean Community, of which Jamaica is one], where political and trade union leadership and support are closely intertwined, it seems unrealistic to expect any such move within the foreseeable future. Although distortions in the wage structure help to produce open unemployment, governments are unlikely to limit the unions' freedom to bargain with the enclave industries and expose themselves to the considerable consequent political risks.<sup>9</sup>

We conclude that the political environment in Jamaica is one where nonmarket wage determination is a political fact of life and will be in the years to come. The country’s development policies must be chosen in accordance with this constraint. We return to this issue below.

#### 4. Wage-Setting Institutions in Hong Kong, Korea, Singapore, and Taiwan

The four East Asian NICs are frequently grouped together in the literature. Indeed, we would note certain similarities about wage-setting institutions among these four economies. Minimum wages exist in some of the countries, but their levels are so low as to be meaningless (Starr, 1981). Only in Hong Kong does trade union bargaining over wages take place free of

government restraint. Public employees receive wages comparable to those in the private sector, but not higher. Multinational corporations also follow market forces. Labor codes have not prevented employers from making desired labor market adjustments. Thus, at the risk of overgeneralizing, we would conclude that market wage determination has generally prevailed in the East Asian NICs.

In other respects, however, the labor market institutions in the East Asian NICs are actually quite diverse. Moreover, such diversity is not based upon size or ethnicity. Singapore and Korea — the least and the most populous — are committed to state intervention in the labor market, while Hong Kong and Taiwan allow market forces to determine labor market conditions. The critical point of difference within the East Asian NICs is whether supply and demand are generally unfettered or, alternatively, whether the State actively intervenes to influence labor market institutions and conditions.

What appears in the statutes does not necessarily reflect the actual institutions in action. This makes analysis more difficult. Among these four economies, Singapore has had the most paternalistic labor institutions. Its government is entirely open about its policy directions. Hong Kong is an archetypal case for *laissez faire*, with minimum government intervention. In Hong Kong as in Singapore, the official circle is quite clear about what it is practicing. In Korea, the labor market is supposedly operating on its own. Yet, the Korean government exercises massive influence over wage determination by behind-the-scenes “jawboning.” As for Taiwan, the economy is supposedly operating under a detailed labor code. But in practice, many provisions simply are not implemented, so that market forces prevail. We now present a more detailed examination of labor market institutions in each of the NICs.

(a) *Singapore*

The early labor history in the Republic of Singapore was marked by the political struggle of the ruling People's Action Party against a communist union. The de-registration of the union, large-scale arrests of union leaders followed by long jail terms, the restriction of fringe benefits (Employment Act, 1963), and the outlawing of strikes (Industrial Relations Act, 1968) were the prices paid for labor peace (Lim and Pang, 1982).

Before 1972, wages in Singapore were determined by market forces. In that year, though, the National Wages Council (NWC) was set up with equal representation from the government, management, and the government-backed National Trade Union Congress (NTUC). Annual guidelines for wage increases have been "recommended" by this quasi-governmental body since 1972. The Singapore political system being what it is, what the government recommends is nearly always followed. Partly this is brought about by government jawboning, partly by the fact that 500 Singaporean companies are partly or totally owned by the government itself (*Fortune*, January 20, 1986), and partly by the fact that representatives of multinational corporations sit on the NWC. Both management and government seem to prefer this system to a free collective bargaining system.

The regulated labor market in Singapore has generally provided a welcome climate for foreign investors. Indeed, this was the motivation for regulating the labor market in the first place. Industrial peace has facilitated rapid economic growth. This growth, being of a labor-intensive character, has caused the Singapore labor market to become extremely tight, with very low unemployment and rising real wages. Furthermore, the Central Provident Fund is a major source of national savings, making resources available for such social programs as government



housing and providing workers with substantial social security protection. These factors have created an acquiescent labor force in Singapore.

However, the very power of the central wage-setting process has itself become a source of instability. The National Wages Council has had substantial influence on wage levels in Singapore over the years. Between 1972 and 1979, the NWC pursued a policy of wage repression, deliberately holding wages down in order to sustain the competitiveness of labor-intensive industries in world markets. To quote Ong Pang Boon, Labor Minister in the mid-1970s: “Our working population may well have to undergo a period of belt-tightening all round ... It is clear that an essential element in our new strategy must be a tighter grip on wage increases ... If we do not quickly and willingly change to low gear on the wages front, we shall further discourage investment and aggravate the unemployment problem.”<sup>10</sup> In those years, real wages rose by 2% while real GDP rose by 9%. The labor market tightened to the point where employers were obligated to compete with one another for scarce labor. Immigration quotas were increased to help remedy the problem of labor shortage. Still, labor was so scarce that economic growth was constrained.

In 1979, the government announced a policy of “wage correction” as part of the “Second Industrial Revolution.” Wages were supposed to increase by 20% per year at a time when prices were rising at an annual rate of 7%; but in the event, wage increases of 14% nominal (7% real) were brought into being. The wage correction policy was permitted to lapse in 1982; it has since been acknowledged to have been a mistake.

In 1982, the NWC endeavored to allow wage levels to be set by market forces. This continued until 1985.

In that year, the Singapore economy faced economic recession. Real GDP declined by 1.7%, resulting in a loss of 90,000 jobs. A complete wage freeze was put into effect. Wage repression remains in force at the time of this writing. As Prime Minister Lee Kuan Yew has recently said: “Only after we have made up the ground lost in the years of negative growth in 1985 and, I fear, also in 1986 . . . can we afford to loosen our policy of wage restraint, and then we must peg future increases in wages to increases in productivity.”<sup>11</sup>

Policy reversals like these are not going to enhance the confidence of private businesses, especially foreign investors. This is one serious defect of the centralized wage system. More subtle defects are also present. The NWC makes across-the-board wage adjustments, thus rigidifying the interindustry wage structure. For an economy keen on upgrading its industrial structure, the maintenance of fixed wage ratios across industries cannot be beneficial.

Another important wage institution in Singapore is the Central Provident Fund (CPF). The vast majority of workers, including the self-employed, are included in this fund. CPF contributions are divided between an ordinary account, a special account, and a Medisave account and are used to fund old age pensions, provide health insurance, purchase residential properties, and fulfill other such social purposes. CPF contributions were as high as 50% of payroll in the past, paid equally by employees and employers. One leading observer of the Singapore labor scene has written: “This has given Singapore the highest national savings rate in the world (42%), [but it was] also a factor in the loss of competitiveness and current economic decline.”<sup>12</sup> The employer’s contribution rate has been lowered from 25% to 10% in the current recession in an attempt by the Singapore government to invigorate employment growth.

Other than the NWC and the CPF, wage-setting institutions are insignificant in Singapore. Unions do not strike, so have little effect on wage outcomes.<sup>13</sup> Minimum wages are

lacking in Singapore. Foreign firms are as well treated, if not better treated, than domestic firms (Deyo, 1981). There seem to be no discriminatory wage regulations against foreign firms.

(b) *Hong Kong*

As in Singapore, the Hong Kong government provides a welfare state for its working class through subsidized housing, etc. But unlike Singapore, there is no Central Provident Fund for this purpose.

In terms of its labor market institutions, as in the economy as a whole, Hong Kong epitomizes *laissez faire* (Cheng, 1977; Hsia and Chau, 1978; Rabushka, 1979; Turner, 1980; Chow and Papanek, 1981). There is no active economic policy, nor planning. Hence, there is no government intervention in wage setting. Specifically, Hong Kong has no minimum wage, special provisions about foreign firms, or clear public sector wage advantage. The effects of the labor code are minimal in Hong Kong, e.g., employers need give workers only seven days' notice before firing or laying off a worker, and must pay only seven days' wages as severance pay. The trade union movement in Hong Kong is neither favored nor discouraged by existing legislation. Strikes are allowed, except by public sector unions. But because of the heavy dependence on export trade, labor unions even where established are wary of raising wages above the market- determined norm.

Rather than industrial conflict, the prevailing free market situation in Hong Kong is one of industrial labor peace. Essentially, a tight labor market has created full employment and rapidly rising real wages. In such circumstances, trade unions hold out little appeal, and are weak

as a result.<sup>14</sup> In short, workers in Hong Kong enjoy considerable economic security under *laissez faire*.

In general, all is well with wage institutions in Hong Kong and little is newsworthy. Perhaps the highest praise is that of Lee Hsien-Lung (the son of Lee Kuan-Yew and heir apparent to political power in Singapore), who has held up the flexibility and resilience of the Hong Kong economy as a model for the economy of Singapore. This points to the strength of the freewheeling economy of Hong Kong, in which the flexibility of wage levels and wage structure play no small part.

### (c) *Taiwan*

In Taiwan, the labor market institutions are still in transition. A Labor Standards Act was promulgated in 1985 to replace several earlier labor laws. Martial law, which up to now has limited labor activity, is slated to be ended soon. To gain perspective, we review both the present situation and what has prevailed over the last three decades of rapid industrialization.

Overall, the guiding principle in Taiwan is “progress amid stability.” This slogan was emblazoned everywhere in the early stages of Taiwan’s industrialization and remains in force, though a bit less visibly, in Taiwan today. The government seeks rapid economic growth to pursue political stability. It is for the same goal that industrial strife is to be avoided at all cost.

The Labor Standards Law of 1985 was intended to regulate certain labor practices by requiring the vesting of pensions and providing for severance pay.<sup>15</sup> The law has been defended by Mr. Po-Hsiung Wu, Minister of Interior, on several grounds, including the preservation of American preferential tariff treatment under GSP and the winning of the approval of the US

media. He also stated that “at our stage of economic development, it is not possible to continue the labor relations of the past.”<sup>16</sup>

The new legislation is intended to protect labor, but it is uneven in coverage and may have unintended side effects. Heavy pension requirements induce firms to fire workers near retirement. Firms are required to offer eight weeks of paid pregnancy leave, which is an inducement not to hire young females. Provisions regarding severance pay have been blamed for discouraging investment. The law provides that employees who were not paid wages to which they were entitled may ask for government arbitration, but such arbitration may be challenged in court.

Unions do very little in Taiwan. Active unionism is regarded as unwarranted, both because it may discourage foreign investment, and hence growth, and because it may create a separate power base outside the government, which might be taken over by forces aligned with the People’s Republic of China or with local opposition. For the same reason, employers may be pressured to mend their ways, if any other course might lead to labor unrest and social instability. Under the Union Act, any factory hiring 30 or more adult workers must be unionized (Articles 4 and 6) except in the munitions industry and government employees. Strikes are outlawed under Article 39 of the martial law. Unions are underfinanced. The Provincial General Labor Union (Taiwan’s equivalent of America’s AFL-CIO) does not have enough funds to hire more than six full-time staffers. Union representatives are heavily outnumbered in the legislature compared to representatives of capitalists.

Taiwan has a formal minimum wage law, but its level is well below the market wage rate. In 1985, the GNP per capita was US \$3,000 (hence approximately \$12,000 for the average

family of four) but the minimum wage for a worker was less than US \$2,000. In fact, in public debate or government policy pronouncements, the minimum wage rate is essentially ignored.

Public sector pay policy has no appreciable wage-raising influence in Taiwan. The government sector pays no more than the private sector and often less.

Firms with foreign investment must be approved case by case when they are established. But once approved, they are not treated any differently from local firms. All the same, any firm may be pressured by the government to satisfy workers' demands if public order is threatened. For example, when DuPont laid off workers in 1985, it was required to pay twice as much severance pay as the law stated.

There is so far no unemployment insurance in Taiwan. Health, injury, and pension plans are paid jointly (employer, 80%; employee, 20%).

#### (d) *Korea*

In Korean labor markets, supply and demand reign. A number of analysts — Moran (1976), Lindauer (1984), Fields (1985), Richardson and Kim (1985), Castaneda and Park (1986) and others — have commented favorably on the efficiency of the Korean labor market, the responsiveness of Korean workers to job opportunities in other locations and other sectors, and the absence of wage distortions owing to trade unions, public sector pay policy, or minimum wages.

Labor unions in Korea are very weak. About 15% of workers in Korea are members of unions — the same as in the United States. However, the powers of unions are severely limited. Workers may form unions but firms are not obligated to conduct bona fide collective bargaining

with them. If bargaining does take place, it must be only at the local level; national unions or the nationwide Federation of Korean Trade Unions may not intervene in collective bargaining on behalf of a local union. In the event of a labor dispute, the law specifies a cooling-off period of 30 days in the case of private sector labor disputes, 40 days in the case of public sector disputes. Arbitration is compulsory.

In 1972, the right to strike was revoked. By the end of the decade, workers took to the streets, rioting against their own union leaders, in the belief that they “were often in collusion with either management or government agencies.”<sup>17</sup> One of the first actions of President Chun’s regime was to pass a new labor law in 1980, establishing company unions subject to the conditions outlined in the previous paragraph. In 1981, the right to strike was reinstated but in a very limited way. The government could intervene in any dispute that threatened to develop into a major job action. In practice, this has meant that the police are sent in after a day or two, and the union leaders are arrested and jailed for up to five years. Thus, the “right” to strike is not much of a right in practice.

Other forces that may push wages up above market-clearing levels are essentially absent in Korea. Public and private pay scales are quite similar to one another. Furthermore, the percentage of pay raise for civil service employees carries great force of persuasion among workers in the private sector. In this way, government endeavors to regulate wage growth in the economy. Foreign firms are not treated differently under the law so far as employment is concerned. However, when one Japanese bank had labor trouble due to alleged discriminatory personnel policies, workers’ protest was not prevented by government security forces, as it would have been if Korean firms had been involved. Korea’s protective labor legislation, applicable only to larger firms, is not a significant impediment to worker mobility.

It is generally thought that wages in Korea have been repressed, at least since 1981. But unlike Singapore, where wage repression was announced openly by the government and instituted by the National Wage Council, wage repression in Korea is far from open:

Acting through the Bankers' Association of Korea, the government also tried to keep wage increases low by having banks restrict credit for firms which increased wages beyond government guidelines. This move in late 1980, however, faced strong resistance from the Federation of Korean Trade Unions. Whenever there was a more explicit confrontation over this issue, the government would say 'There is no official guideline. It is just a suggestion on the part of the government.'<sup>18</sup>

But considering the heavy involvement of government in the Korean economy and in the society, "suggestions" carry a great deal of force. Government's efforts at jawboning lower wages are viewed by many labor economists in Korea (e.g., Bai, 1985) as having led to "wage repression."

Wage repression, if effective, would ordinarily be expected to lead to shortages of labor relative to the available supply at the artificially low wage. But by holding down wages throughout their economies, the authorities in Singapore and Korea formed a kind of cartel, to which the standard theory of labor market monopsony (e.g., Ehrenberg and Smith, 1988, p. 72) would apply. Firms hire up to the point where marginal labor cost equals marginal revenue product, but then pay a low wage which reduces quantity of labor supplied and clears the market. The labor shortage, though concealed, nonetheless restricts production and growth.

As 1986 drew to an end, Korea had no minimum wage. However, one year earlier, the government had announced a plan to institute a minimum wage in the near future. A planning committee was formed in conjunction with the Sixth Socioeconomic Plan to work out a proposed scheme. The idea on the table was to establish regional minimum wage boards, consisting of equal numbers of representatives of management, labor, and the public interest. These boards would recommend minimum wages for specific occupations and industries in their jurisdictions.



Initially, the minimum wage would apply to eight low-paying manufacturing industries — textiles, footwear, etc. — and would later be extended more widely.

The Korean authorities are well aware of the serious risks minimum wages pose. They worry about adverse effects on employment and international competitiveness. Yet, they feel a minimum wage is necessary at this point, partly because a social consensus now seems to have been reached that certain groups of workers are paid unacceptably low wages, partly because these workers and their sympathizers have taken to the streets in support of minimum wages, and partly because the US Trade Representative would be mollified in Korea could show that its exports to US markets were not produced by “sweated” labor (and thus protective measures in the United States would be averted). It appears that whatever the minimum wage is that will finally be enacted in Korea, it will probably be restricted to workers in large firms in a small number of industries and its level will be set to avoid serious disemployment effects. It is not likely, therefore, that the forthcoming minimum wage in Korea will significantly affect the market wage determination process.

## 5. Wages and Economic Growth

Wage policy in the East Asian economies proceeded in two stages. At first, premature wage increases were to be avoided; this would permit economic growth to increase employment. Then, in this second stage, once full employment was attained, the heightened competition for workers would lead employers to bid up wages.

As shown by the figures in Table 1, this indeed happened. Unemployment rates have been of the order of 1-4%. The mix of employment shifted in favor of better paying categories.

Real wages rose, often at the same rate as GNP. Income inequality in the East Asian NICs is low to moderate by world standards. Absolute poverty fell as economic growth took place.

As wages rose, policies were introduced aimed at economizing on the use of increasingly scarce labor and enhancing labor productivity through investments in complementary physical and human capital. But sustained economic growth brought with it continued high demand for labor, resulting in further wage increases.

The effect on standards of living is described graphically by Lim for the case of Singapore:

In both the NICs and the non-NICs, the absolute standard of living made possible by an export factory worker's wage is also fairly high ... the average wage of a female electronics worker in Singapore puts her family in an income bracket where 96% of the households have a refrigerator and television, 45% have a washing-machine, 25% a video-cassette recorder, etc.<sup>19</sup>

Would that the workers in other countries could live so well!

Export-led growth contributed to the East Asian economies' successful development. So too did market wage determination.

As other countries plan their development strategies in light of the successful experiences of the East Asian NICs, an important point should be kept in mind. Whether an export-oriented trade strategy is better or worse than an inward-oriented strategy may well depend on a country's choice of wage policy. Consider the case of active export promotion through subsidies, infrastructure provision, or other external benefits to the export sector. Suppose that in these circumstances, an export-promoting country permits premature wage increases to be granted, and suppose further that because labor costs often constitute the largest share of total cost of a product, that the country's exports become unprofitable in world markets. The revenues earned by private companies may fail to equal the social costs of exporting. In this case, an export-

oriented development strategy subsidized by the government may cause the country to lose money. Export promotion would be a costly misuse of resources in such a circumstance — a lesson which potential exporters, and those who advise them, should be careful to heed.

## 6. Conclusions

We have compared wage-setting institutions in the economies of Hong Kong, Korea, Singapore, and Taiwan with those in Costa Rica, Panama, and Jamaica. Those institutions which raise wages appreciably above market-clearing levels in key sectors in many developing economies — minimum wages, trade unions, government pay policy, pay policies of multinational corporations, and labor codes — have had little role to play in the East Asian NICs.

Although the NICs have generally relied on market wage determination, they have done so with very different amounts of government involvement. The governments of Singapore and Korea have been the most interventionist, applying government power to restrict wage growth. The Hong Kong government has adopted perhaps the most *laissez-faire* set of labor market policies of any government in the world. Taiwan is closer in that respect to Hong Kong than to Korea or Singapore. The difference, interestingly, is not between the larger economies and the city-states but between the overall amount of central direction in their respective economies. But when confronted by labor unrest and entrepreneurial flight respectively, the governments of Korea and Singapore were forced to subordinate their iron will to economic inevitability. Thus, when wide departures from the market wage rate threatened to slow the engine of growth, they reversed their courses and turned again to market forces.

Whereas avoidance of premature wage increases dominated wage policy in the NICs in the past, conscious efforts are now being made to push wages up somewhat. As we have described, Taiwan introduced a new labor law in 1985 and Korea is actively considering introducing a minimum wage. Whether market determination will prevail in the East Asian NICs in the future as it has in the past remains to be seen. We predict that it will. The NICs' governments are well aware that market wage determination has served them very well up to now. This awareness is perhaps the strongest reason to predict that they will not seriously distort wages in the future.

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Insert Table 1 Here

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The fact is that the East Asian NICs have done better than economies elsewhere. The NICs have attained full employment, pronounced improvements in real wages, and rapidly rising prosperity. They have done so while letting supply and demand dominate their labor markets.

We draw the following conclusions from the record:

- (1) A market-determined wage rate, combined with an export-oriented economy, can absorb large numbers of workers in a few short years. By contrast, high minimum wages, militant unionism, or overzealous social legislation appear to impede growth of employment and output and hence do little to help country-wide poverty.
- (2) Wage repression is unnecessary and undesirable at this stage — unnecessary because, as in the experience of Hong Kong, full employment can be attained quickly; undesirable because, as in the experience of Korea, wage repression generates workers' resentment and endangers industrial peace.

- (3) What justifies initial wage restraint is the rapid rise in labor earnings that accompanied the East Asian NICs' economic growth. Real earnings grew much more rapidly in Hong Kong, Korea, Singapore, and Taiwan than in Latin America, both because full employment was attained and because real wages per hour are sharply higher. As a result, the workers in the East Asian NICs live very much better than they did a decade or two ago.

The successes of market wage determination point to a direction that other countries might pursue to advantage. But this call should not be misinterpreted. The goal of any economic system is to provide higher standards of living for people. Living standards should not be sacrificed to economic growth *per se*. Nor is *laissez faire* capitalism necessarily the best form of economic organization. What we would highlight is that when supply and demand have determined wages and when economic growth consistent with comparative advantage has taken place, outcomes have been favorable at both the macro and the micro levels. Standards of living have jumped as a result.

Looking ahead, more work needs to be done analyzing both theoretically and empirically the interactions between countries' labor market policies and their development strategies. For a start on theoretical work along these lines, see Fields (1989).

## Notes

1. Throughout this article, the term “Korea” is used to refer to the Republic of Korea.
2. For further reading on these institutions in Latin America and their political antecedents, see Deyo (1986).
3. Says Gregory (1981, p. 400): “The omission of trade unions from considerations as a significant force stems from the wide consensus I found in Costa Rica that they are not particularly powerful and do not represent a significant independent influence on wage levels except perhaps in some of the semiautonomous public corporations.”
4. See, for instance, PREALC (1979).
5. Following the use of the term “social security” (“*seguridad social*”) throughout Latin America, we are using that term here to refer in general to economic security programs and not just in reference to government-provided old age pensions, as in American English.
6. Spinanger (1985), p. 65. For further analyses of wages and employment in Panama, see Morley (1984) and Sjaastad (1985).
7. Tidrick (1975), pp. 308-309.
8. Chernick (1978), p. 86.
9. Chernick (1978), p. 86.
10. *The Straits Times*, February 29, 1976.
11. *Asian Wall Street Journal*, June 24, 1986.
12. Lim (1986), p. 13.

13. Lim and Pang (1982, p. 116) refer to this as the “progressive pacification of the Singapore labour movement,” noting that only one work stoppage was reported in 1977 and none since then.
14. Throughout the world, trade unions are strongest when labor markets are slackest.
15. Vested pensions are those which must be paid even if the worker leaves the firm voluntarily or is laid off.
16. Interview in *Commonwealth*, January 31, 1986).
17. Wickman (1982), pp. 123-124.
18. Nam (1984), pp. 73-74.
19. Lim (forthcoming), p. 10.

Table 1

Table 1. *Changes in labor market conditions and income distribution in four newly industrializing Asian countries*

	Hong Kong	Korea	Singapore	Taiwan
Unemployment rate	1961: 1.7% 1971: 4.4% 1976: 4.3% 1980: 3.7%	1963: 8.2% 1967: 6.2% 1971: 4.5% 1976: 3.9% 1981: 4.1%	1957: 5.2% 1965: 9.1% 1969: 10.4% 1971: 7.0% 1977: 4.8% 1980: 3.5%	1955: 6.3% 1963: 4.3% 1972: 1.5% 1981: 1.3%
Employment composition				
A. Agriculture as a % of total employment	1961: 7.4% 1971: 4.0% 1976: 2.5% 1980: 1.4%	1963: 63.2% 1970: 50.4% 1980: 34.0%	1957: 6.9% 1970: 3.5% 1979: 1.5%	1964: 50.0% 1970: 36.8% 1979: 21.5%
B. Employees as % of economically active population	1961: 83.8% 1971: 87.3% 1980: 89.4%	1963: 31.5% 1971: 39.3% 1980: 47.3%	1957: 73.7% 1970: 76.5% 1979: 83.5%	1956: 36.8% 1964: 39.2% 1970: 50.7% 1979: 63.7%
C. Professional & technical administrative & managerial, clerical, and sales occupations as % of economically active population	1961: 27.5% 1971: 26.8% 1976: 28.3% 1980: 32.5%	1963: 16.9% 1970: 22.9% 1980: 29.5%	1957: 36.8% 1970: 39.4% 1979: 42.5%	1964: 22.4% 1970: 26.9% 1979: 30.0%
D. % of employed workers with no schooling [% illiterate in brackets]	1961: 20.2% 1971: 16.2% 1976: 13.9% 1980: 10.4%	1960: 44.7% 1970: 23.8% 1980: 16.0%	1966: 54.1% 1972: 20.6% 1977: 35.2% 1980: 22.5%	1965: [26.0%] 1970: [20.7%] 1975: [15.9%] 1980: [9.0%]
Real wages or earnings	Index of average real manufacturing wage, 1984 = 100: 1960: 105 1965: 157 1970: 167 1975: 194 1980: 253	Index of real earnings, 1975 = 100: 1966: 52 1972: 88 1978: 154 1980: 159	Index of real income per worker, 1966 = 100: 1966: 100 1975: 100 Index of real weekly earnings, all industries, 1975 = 100: 1975: 100 1980: 120	Index of real manufacturing earnings, 1954 = 100: 1954: 100 1960: 102 1970: 183 1979: 400
Poverty	% of households with annual incomes less than HK \$3000, in constant 1966 HK\$: 1966: 18% 1971: 11% 1976: 7%	% of households with incomes below a constant real poverty line: 1965: 41% 1970: 23% 1976: 15%	% of persons with incomes below S \$200 per month in 1975 prices: 1966: 37% 1975: 29% 1980: 18%	% of households with incomes below specified figure in specified year: NT \$20,000 1964: 35% 1972: 10% NT \$40,000 1964: 80% 1972: 35%
Inequality, as measured by Gini coefficient among households [Gini coefficient among individuals in brackets]	1966: 0.487 1971: 0.411 1976: 0.435 1981: 0.447	1964: 0.34 1970: 0.33 1976: 0.38	1966: [0.499] 1975: [0.452] 1980: [0.455]	Early 1950s: 0.5 1968-72: 0.3 1976-78: 0.27

Source: Fields (1984, 1985).



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